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Adviser factsheet

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Annual allowance – the test

Introduction

The annual allowance (AA) limits the amount of tax privileges available on pension savings made by or in respect of an individual under a registered pension scheme. This factsheet provides an introduction to the AA test.

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The test

Where the increase in an individual's pension savings, as determined by legislation, exceeds the AA in a tax year, the AA charge may apply to the excess.

In certain circumstances an individual may trigger the money purchase annual allowance (MPAA). The purpose of the MPAA is to stop individuals abusing the pension freedoms that came into effect from 6 April 2015. Like the AA it restricts tax privileges and because the freedoms impact directly on money purchase arrangements, it places an additional restriction on pension saving through these types of arrangements.

For further information on the events that trigger the MPAA please refer to the Tech Talk.

Since 6 April 2016, where an individual is a high income individual (as defined by legislation) in a tax year, they will be subject to a tapered AA in that tax year.

How does the test work?

To determine if an individual has made excess pension savings in respect of a tax year it is necessary to calculate their total pension input amount for the tax year.

The total pension input amount is arrived at by aggregating the pension input amounts for each of the individual's arrangements under all registered pension schemes of which the individual is a member and all overseas pension schemes the individual is a member of where post 5 April 2006 they or their employer qualified for UK tax relief. The pension input amounts are measured over the corresponding pension input periods. The total pension input amount is the amount of the increase in the individual's pension savings over the pension input periods ending in the tax year. This increase is tested against the AA for the tax year.

The rules for calculating pension input amounts depend on the type of pension arrangement e.g. money purchase (not cash balance) or defined benefit, and are covered in the: Annual allowance – pension input amounts factsheet.

Since 6 April 2016 pension input periods have been aligned with tax years.

Where the MPAA is a factor, the test is far more complicated and for that reason is not covered in this factsheet. If more detail is required please refer to the Tech Talk.

AA charge

The AA charge is a tax charge on the individual. It arises where the total pension input amount for the individual in respect of the tax year exceeds the amount of the AA plus any unused AA available from carry forward (see next section). The AA charge is levied on the excess.

The rate at which the AA charge is levied depends on the 'reduced net income' of the individual and the amount of the excess they have in the tax year.

To calculate the amount of the charge involves working out the rate or rates of tax that would be charged on the excess pension savings assuming it was added to the individual's reduced net income for the tax year. PTM056100 gives more detail.

Normally the individual will account for any AA charge through Self Assessment.

An individual may have the right to elect to require the scheme administrator of their pension scheme to pay some or all of their AA charge liability on their behalf in return for an appropriate reduction in their pension benefits. This is known as 'Scheme Pays' and it is an option for the individual if the following conditions are met:

- their AA charge liability for the tax year has exceeded £2,000 and
- the total amount of their pension savings in the pension scheme for the same tax year has exceeded the AA.

Where an individual does not meet the conditions for 'Scheme Pays' to apply or they do not make their nomination in time then a scheme may decide to pay the member's AA charge on a voluntary basis.

PTM056300 provides more information on who is liable for the AA charge.

Carry forward of unused AA

If an individual has a pension input amount of more than the AA in a tax year they may not necessarily be liable for an AA charge in that tax year. They can carry forward any AA that they have not used in the previous three tax years. The amount of unused AA can then be added to the AA in the tax year in which it is being carried forward to in order to provide a higher AA to offset against that year's pension input amount.

To carry forward unused AA from a previous year, the individual must have been a member of a registered pension scheme at some point in that tax year. For this purpose, member includes active member, pensioner member, deferred member or pension credit member.

It is worthwhile pointing out that it is unused AA that is being carried forward and not unused tax relief.

Appendix (level of allowances, current and historic)

AA

2006/07	£215,000
2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/11	£255,000
2011/12	£50,000
2012/13	£50,000
2013/14	£50,000
2014/15	£40,000
2015/16 pre-alignment tax year	£80,000
2015/16 post-alignment tax year	£0*
2016/17 to 2022/23 (tapering applies to high income individuals)	£40,000
2023/24 onwards (tapering applies to high income individuals)	£60,000

* £40,000 if individual was not a member of a registered pension scheme at any time during the pre-alignment tax year

MPAA

2015/16 – see Tech Talk Money purchase annual allowance 2015/16 and beyond

2016/17	£10,000
2017/18 to 2022/23	£4,000
2023/24 onwards	£10,000

Alternative AA (where MPAA has been triggered)

2015/16 – see Tech Talk Money purchase annual allowance 2015/16 and beyond

2016/17 (tapering applies to high income individuals)	£30,000
2017/18 to 2022/23 (tapering applies to high income individuals)	£36,000
2023/24 onwards (tapering applies to high income individuals)	£50,000

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